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JAPAN AIMS FISCAL WEAPONS AT ECONOMIC GROWTH: BULLETS OR BLANKS?

SUMMARY

After enjoying several years of bountiful revenues, Japanese fiscal planners face hard times as the speculative financial excesses of the late 1980s are wrung out of the economy. At the same time that revenues are shrinking, domestic and foreign pressures on Japanese fiscal policy are building for ever greater spending. Fiscal planners, loathe to surrender the hard-won cuts in the budget deficit achieved through FY 1990, are seeking new revenue sources. But with few promising candidates in sight, the government is watching each yen with renewed vigor. If Tokyo cannot employ fiscal tools to invigorate its own economy, observers wonder, how can the Japanese government expect to play a larger role in solving costly international problems? Thus, Japanese fiscal policy faces rising expectations against a backdrop of dwindling resources.

Background

From the end of the U.S. occupation through the early 1970s the Japanese government's approach to managing overall economic growth can be characterized as monetarist. Careful controls on money supply growth, bank lending and foreign exchange reserves largely set the boundaries for economic activity. The economy experienced an excess of demand in this period as the nation strove to rebuild its war-torn industries and economic infrastructure. Monetary policy, thus, was used more as a brake on economic activity than as a prod. Fiscal policy was given the dual tasks of raising the level of industrial technology and creating the infrastructure (transportation and communication networks, for example) to support industrial reconstruction.

With the reconstruction process mainly complete by the early 1970s, several Japanese industries had emerged as world-class competitors. The end of fixed exchange rates in 1971 and the 1973-74 oil shock severely shook this rebuilt industrial structure. Faced with stagnating demand and rising inflation, which could not be addressed by an easier monetary policy alone, Tokyo adopted a standard Keynesian remedy — deficit spending. Government bond issues surged as the government

attempted to spend its way out of the slump. By the end of the decade, however, officials realized that the double-digit growth rates enjoyed in the 1950s and 1960s were unachievable by Japan's larger and more mature economy. The surge in deficit spending, moreover, had left a legacy of a large outstanding debt to be serviced, a problem new to Japanese planners.

In the 1980s worry over the budget deficit and the outstanding debt generated a consensus that the government not only must bring the current deficit under control but reduce the mountain of outstanding debt. The Ministry of Finance began by initiating a policy in FY 1987 of selective austerity — combining moderate increases in discretionary general account spending with a rapid reduction of new borrowing — to help whittle down the deficit. Late that year strong economic growth, facilitated by monetary growth and driven by solid consumer spending and rapidly expanding private capital investment, proved strong enough to generate tax revenue growth well above the levels forecast by budget planners. This revenue bounty allowed Tokyo to eliminate new issues of deficit-financing bonds as of FY 1990.

Despite — or in addition to — its successes in the management of debt and deficit, Tokyo's combination of stimulative and contractive fiscal measures has worked to limit the public sector's role in overall economic growth. Tokyo still influences economic activity in several ways, however. The government can cut or raise taxes selectively; boost spending via supplemental appropriations (as was done in late 1987 to counter the negative effects of the yen's sharp appreciation against the dollar); reallocate general account funds to favor specific areas (as has been done for foreign aid); and focus outlays of the Fiscal Investment and Loan Program, the major source of capital spending, to stimulate desired areas of economic activity (greater public works spending and bigger foreign aid budgets, for example). While all these options are employed in the FY 1992 central government fiscal plan, the debate is growing over their effectiveness.

The General Account

The centerpiece of Japanese fiscal policy traditionally has been the general account budget since it funds the current operations and activities of the central government. Because line items in the general account budget represent direct spending and are highly visible, they play a major role in both the psychological and the real aspects of fiscal policy. Moreover, the policy of selective austerity shows most clearly in the general account.

Expenditures - There is a clear break between FY 1990 and FY 1991 in the pattern of overall growth of general account spending (see Table 1). From FY 1987 through FY 1990 the rise in aggregate spending easily outpaced the expansion of gross national product. This charged performance stemmed mainly from the uncontrollable growth of mandatory payments (see Table 2) — transfers to local governments, which are a fixed percentage of specific central government taxes and therefore rise in step with the growth of general tax revenues, and interest costs on the national debt, which are determined partly by the amount of outstanding debt the government must roll over and partly by current interest rates. In contrast, the expansion of discretionary outlays modestly surpassed the rate of inflation prior to FY 1990 but fell short of the rate of overall economic growth. In FY 1990 discretionary spending was flat as MOF pushed particularly hard to hold down expenditures to compensate for the nearly 20 percent jump in interest payments on the national debt and to achieve its cherished goal of halting new issues of deficit-financing bonds. Also in FY 1990 and FY 1991 budgeteers had to contend with Tokyo's pledge to contribute a total of about $13 billion to the multinational operation set up to free Kuwait from the occupying Iraqi army. Squeezing this large contribution into an already tight budget took accounting as well as political skill.

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Table 1: Japan's General Account Expenditures (Revised), FY 1988-FY 1992*

(in billions of yen and percent change)

	FY 1988		FY 1989		FY 1990		FY 1991		FY 1992**	
Total Expenditures	¥61,851.7	6.3%	¥66,311.9	7.2%	¥69,651.2	5.0%	¥70,613.5	1.4%	¥72,218.0	2.7%
Social Security	11,801.4	14.3	12,474.2	5.7	11,544.6	-7.5	12,196.2	5.6	12,737.4	4.3
Public Assistance	1,062.0	-3.9	1,080.6	1.8	1,050.8	-2.8	1,018.2	-3.1	1,061.3	-1.2
Social Welfare	2,146.3	5.6	2,309.7	7.6	2,446.8	5.9	2,634.0	7.7	2,818.8	8.8
Social Insurance	7,732.3	22.5	8,203.4	6.1	7,204.8	-12.2	7,646.4	6.1	7,888.4	3.8
Health Services	500.7	-2.3	526.4	5.3	561.8	6.7	600.5	6.9	641.1	5.3
Unemployment Compensation	360.2	-1.2	354.1	-1.7	280.5	-20.8	297.1	5.9	327.7	-3.2
Education and Science	4,982.0	-1.6	5,075.3	1.9	5,359.4	5.6	5,562.7	3.8	5,688.4	5.4
Compulsory Education	2,463.5	3.0	2,475.5	0.5	2,642.6	6.8	2,768.4	4.8	2,726.3	3.3
Transfer to School Account	1,124.4	-4.7	1,184.8	5.4	1,264.3	6.7	1,304.8	3.2	1,379.6	9.0
Science and Technology Promotion	426.6	-9.9	453.9	6.4	474.2	4.5	499.1	5.3	547.8	8.0
School Facilities	283.3	-20.1	262.7	-7.3	244.3	-7.0	254.4	4.1	271.9	9.4
School Aid	601.0	3.5	615.4	2.4	650.3	5.7	649.5	-0.1	668.8	3.3
Student Loans	83.3	2.0	83.0	-0.4	83.7	0.8	86.5	3.3	88.9	2.5
Public Works	6,683.0	-10.0	7,398.9	10.7	7,013.2	-5.2	7,343.4	4.7	8,024.3	21.8
Erosion and Flood Control	1,059.4	-13.3	1,080.6	2.0	1,087.3	0.6	1,147.3	5.5	1,415.8	23.4
Road Improvement	1,744.1	-12.1	1,782.6	2.2	1,789.2	0.4	1,900.1	6.2	2,289.4	20.5
Harbors and Airports	497.1	-12.8	511.5	2.9	515.0	0.7	545.0	5.8	645.0	18.4
Housing	930.3	-3.5	1,539.2	65.5	930.9	-39.5	974.7	1.8	930.8	15.1
Social Infrastructure	942.6	-14.8	954.9	1.3	957.4	0.3	1,034.5	8.1	1,340.1	29.5
Agricultural Infrastructure	852.4	-11.5	867.8	1.8	870.5	0.3	910.1	4.5	1,103.6	21.3
Forestry and Industrial Water Supplies	163.0	-10.0	169.1	3.7	157.8	-1.5	165.8	5.1	218.4	31.7
Disaster Reconstruction	483.8	12.1	482.3	-0.3	694.7	44.0	654.6	-5.8	68.2	0.0
Reserves	10.4	-11.9	10.9	4.8	10.6	0.2	11.2	5.7	12.9	15.2
Pensions	1,879.8	-0.8	1,855.7	-1.3	1,837.4	-1.0	1,808.3	-1.6	1,783.9	-1.4
Civil Servants	118.1	-3.4	111.8	-5.3	107.8	-3.6	104.7	-2.9	101.5	-3.1
Veterans	1,599.0	-0.5	1,588.5	-0.7	1,580.5	-0.5	1,560.8	-1.2	1,547.5	-0.9
Other Pensions	154.4	-2.0	147.4	-4.5	141.0	-4.3	134.6	-4.5	128.7	-4.5
Administrative Costs	8.4	-5.6	8.0	-4.8	8.0	-0.2	8.1	1.3	6.2	-24.4
Local Finance	13,031.2	17.5	14,964.7	14.8	15,930.8	2.8	15,800.2	-0.8	15,771.9	-1.3
Local Allocation Tax	13,031.2	17.5	14,964.7	14.8	15,930.8	2.8	15,800.2	-0.8	15,771.9	-1.3
Interest Support and Special Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National Debt Service	12,030.7	1.5	12,089.8	0.5	14,449.3	19.5	15,536.6	7.5	16,447.3	2.6
Defense	3,728.3	6.3	3,969.9	6.5	4,254.1	7.2	4,440.0	4.4	4,551.8	3.8
Economic Cooperation	714.4	8.0	750.6	5.1	802.0	6.8	864.8	7.8	905.1	7.0
Small Business Assistance	257.6	-2.1	240.5	-6.6	240.9	0.2	214.6	-10.9	195.6	0.3
Energy Support	458.4	-7.7	546.1	19.1	547.1	0.2	589.3	7.7	631.3	6.6
Food Agency Account	480.4	-30.2	459.2	-4.4	404.6	-11.9	381.5	-5.7	342.1	-8.3
Miscellaneous	4,304.6	0.3	4,987.1	15.9	5,642.7	13.1	4,425.9	-21.6	4,577.3	5.1
Salary Increase Reserve	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	135.0	n.a.	0.0	-100.0
Reserves	200.0	0.0	200.0	0.0	325.0	62.5	150.0	-53.8	350.0	133.3
Industrial Investment Special Account	1,300.0	183.8	1,300.0	0.0	1,300.0	0.0	1,300.0	0.0	216.6	-83.3
Persian Gulf Contribution***	n.a.	n.a.	n.a.	n.a.	(1,300.0)	n.a.	300.0	n.a.	n.a.	n.a.

*Revised budget figures include the supplementary budget.
**Initial budget. Percent changes are based on the initial budget for FY 1991.
***¥1.3 trillion was appropriated in two supplemental budgets and included under Miscellaneous. The FY 1991 amount actually was disbursed in FY 1990.

Source: Ministry of Finance

On a line-item basis selective fiscal austerity clearly remains in effect for the budget year that began April 1. At the heart of the austerity drive is an informal MOF rule issued in FY 1986 under which every government agency has to cap capital outlays and reduce by 10 percent its current operating costs. Despite this tough guideline, the fate of each category in Table 1 largely is determined by hard-fought negotiations between MOF and other agencies in every budget cycle. The Finance Ministry has proved tough but not inflexible; no budget item has been cut consistently, but few items have escaped MOF's "negative ceiling" rule unscathed.

Political factors figure heavily in budget negotiations. Defense and foreign aid have been accorded special treatment because of strong foreign pressure for greater spending in these areas. With the exception of FY 1989, economic cooperation, for example, has been granted increases of 6 percent or more since FY 1987. Energy programs, out of favor in the mid-1980s, recaptured Tokyo's attention following the Persian Gulf crisis. Until FY 1991 defense spending also had registered above-average gains of 6 percent-plus annually. The end of the Cold War and the rapid disintegration of the Soviet Union, however, ended the charmed life of defense outlays and starkly illustrated that a loss of political importance usually is followed by funding cuts. While foreign pressure may tip the balance of budget negotiations in any one category's favor, it is not sufficient to guarantee year-to-year growth. The budget for public works, for example, has been volatile despite steady American pressure on Tokyo to spend more in this area.

Among the least glamorous but most demanding budget items is the cost of servicing the national debt. In the initial FY 1992 budget this category gains the dubious distinction of being the largest line item, even though at an expected ¥16.4 trillion-plus ($121.8 billion at ¥135=$1.00) or 22.8 percent of total general account spending, it will be up only 2.6 percent. That projection contains good and bad news. The actual interest component of this item will just top ¥15 trillion ($111.1 billion), a gain of 7.1 percent over FY 1991's ¥14 trillion mark ($103.7 billion). The remainder (¥1.4 trillion or $10.4 billion) will be used to redeem some of the outstanding debt. Although this will be the third year in a row that MOF plans to retire debt, the portion targeted for FY 1992 is no greater than the year before. MOF analysts hope that the Bank of Japan's April 1 discount rate cut and other measures that lower interest rates will cut the cost of refinancing the debt and improve the buy-back figure.

Transfers to local governments, the other main component of nondiscretionary funding, presents a case study of not only the constraints facing MOF when revenue prospects are restricted but how the ministry responds in such situations. Under Japanese law the central government distributes to local governments a fixed percentage of the personal income, corporate income, liquor, tobacco and consumption taxes it collects. Furthermore, revenues from gasoline, vehicle tonnage and aviation fuel taxes are distributed to local governments according to the amount of vehicle and plane traffic they support. (See *JEI Report* No. 41A, November 1, 1991 for a detailed review of local government.) As central government revenues boomed in the late 1980s, so did local revenue-sharing. The converse now is true, too. As taxes collected by Tokyo have dropped, the growth of local transfers has halted. MOF accelerated the reversal even further in FY 1992 when it reduced the percentages used to calculate local transfers. Finance officals justified the change in the formerly sacrosanct formulas by arguing that local government coffers are so full after several years of massive transfers that the money cannot all be spent. It is not clear if MOF's adjustments are permanent, but they do illustrate the degree of pressure MOF budget planners face.

Japan's nearly $9 billion second contribution to the U.S.-led multinational forces that ended Iraq's occupation of Kuwait provided a unique twist to both the FY 1990 and the FY 1991 budgets. This second contribution, which at the time it was pledged amounted to ¥1.17 trillion, was appropriated in FY 1990 via a second supplementary budget. It was financed mainly by a special bond issue, which was to be redeemed in a year with revenues from special, temporary levies on corporate income and petroleum imports, and a delay in the reduction of other taxes. To prevent a skewed analysis of budget trends MOF has tried to keep the Persian Gulf contribution and its related funding measures separate from standard appropriations.

Table 2: **Japan's Discretionary General Account Spending (Revised), FY 1988-FY 1992***

(in billions of yen and percent change)

	FY 1988		FY 1989		FY 1990		FY 1991		FY 1992**	
Total Expenditures	¥61,851.7	6.3%	¥66,311.9	7.2%	¥69,651.2	5.0%	¥70,613.5	1.4%	¥72,218.0	2.7%
Minus										
Debt Service and Transfers to Local Governments	25,061.9	9.3	27,054.5	8.0	30,380.1	12.3	31,366.8	3.2	32,219.2	-2.7
Equals										
Discretionary Spending	36,789.8	4.3	39,257.4	6.7	39,271.1	0.0	39,276.7	0.0	39,998.8	7.4

*Revised budget figures include the supplementary budget.
**Initial budget. Percent changes are based on the initial budget for FY 1991.

Source: Ministry of Finance

Table 3: **Japan's General Account Revenues (Revised), FY 1988-FY 1992***

(in billions of yen and percent change)

	FY 1988		FY 1989		FY 1990		FY 1991		FY 1992**	
Total Revenues	¥61,851.7	6.2%	¥66,311.9	7.2%	¥69,651.2	5.0%	¥70,613.5	1.4%	¥72,218.0	2.7%
Tax and Stamp Revenues	48,106.0	11.7	54,227.0	12.7	59,131.0	9.0	58,990.0	-0.2	62,504.0	1.2
Direct Taxes	36,284.0	14.5	41,541.0	14.5	44,842.0	7.9	43,196.0	-3.7	45,821.0	-2.6
Income Taxes	16,928.0	4.6	20,057.0	18.5	24,345.0	21.4	25,738.0	5.7	27,279.0	6.0
Withheld	12,675.0	3.0	15,020.0	18.5	18,280.0	21.7	20,095.0	9.9	21,288.0	5.9
Self-Assessed	4,253.0	9.5	5,037.0	18.4	6,065.0	20.4	5,643.0	-7.0	5,991.0	6.2
Corporate Taxes	17,712.0	29.1	19,577.0	10.5	18,637.0	-4.8	17,458.0	-6.3	18,122.0	-5.9
Special Surtax	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	404.0	n.a.
Inheritance and Gift Tax	1,644.0	-8.3	1,907.0	16.0	1,860.0	-2.5	2,046.0	10.0	2,260.0	10.5
Land-Holding Tax	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	420.0	n.a.
Indirect Tax Revenues	11,822.0	3.9	12,686.0	7.3	14,289.0	12.6	15,794.0	10.5	16,683.0	13.3
Consumption Tax	n.a.	n.a.	3,618.0	100.0	4,870.0	34.6	4,944.0	1.5	4,968.0	0.5
Commodity Tax	1,906.0	13.1	0.0	-100.0	0.0	0.0	0.0	0.0	0.0	0.0
Liquor Tax	2,066.0	1.2	1,801.0	-12.8	1,914.0	6.3	2,000.0	4.5	2,025.0	1.3
Tobacco Excise Tax	1,011.0	-0.1	932.0	-7.8	957.0	2.7	987.0	3.1	1,012.0	2.5
Gasoline Tax	1,314.0	-17.7	1,365.0	3.9	1,423.0	4.2	1,503.0	5.6	1,576.0	4.9
Petroleum Tax	290.0	52.6	438.0	51.0	453.0	3.4	490.0	8.2	507.0	3.5
Motor Vehicle Tonnage Tax	532.0	9.5	559.0	5.1	628.0	12.3	640.0	1.9	674.0	5.3
Securities Transaction Tax	1,800.0	1.9	1,234.0	-31.4	1,020.0	-17.3	492.0	-51.8	615.0	-39.7
Customs Duty	703.0	17.4	759.0	8.0	864.0	13.8	850.0	-1.6	879.0	3.4
Other	227.0	12.9	131.0	-42.3	134.0	2.3	139.0	3.7	134.0	-3.6
Stamp Revenue	1,973.0	9.2	1,849.0	-6.3	2,026.0	9.6	1,703.0	-15.9	1,663.0	-22.6
Monopoly Profits	8.0	33.3	7.7	-3.8	8.3	7.8	8.6	3.6	10.1	17.4
Public Enterprise Receipts	16.7	-4.6	16.9	1.7	17.6	4.1	19.0	8.0	18.9	-0.5
Sale of Public Properties	126.1	-30.2	173.3	37.5	128.5	-25.9	127.2	-1.0	109.3	-14.1
Miscellaneous	1,353.5	-14.7	2,385.4	-10.1	2,505.3	5.0	3,234.7	29.1	2,211.5	-25.7
Public Bonds	7,967.0	-24.4	7,111.0	-10.8	7,312.0	2.8	6,730.0	-8.0	7,280.0	36.3
Construction	6,196.0	-9.9	6,430.0	3.8	7,312.0	2.8	6,730.0	-8.0	7,280.0	36.3
Deficit-Financing	1,771.0	-51.6	681.0	-61.5	0.0	-100.0	0.0	0.0	0.0	0.0
Carryover Surplus	2,974.6	27.2	2,390.6	-19.6	548.6	-76.5	1,503.9	174.1	84.3	-17.3

*Revised budget figures include the supplementary budget.
**Initial budget. Percent changes are based on the initial budget for FY 1991.

Source: Ministry of Finance

Among discretionary spending categories public works stands out clearly in the FY 1992 initial budget for its unusually large increase of 21.8 percent. Tokyo's response to the lagging domestic economy has focused on public works spending but, despite the big initial increase, domestic and foreign critics charge that it will not be enough to jump start the sputtering economy. Even a larger increase, some argue, may not be effective, implying that fiscal policy has lost its punch to stimulate the world's second-largest economy. Public works spending for all of FY 1992 no doubt will be bolstered further by a hefty supplemental budget if the economy indeed fails to show signs of renewed vigor by the fall. The debate over fiscal policy's efficacy, however, will not fade away.

The other notable discretionary item is the modest 3.8 percent increase penciled in for defense spending in FY 1992. This small gain is due in part to the end of the Cold War and in part to Japan's Persian Gulf contribution. A cut in defense spending was an element of the deal struck by the government with opposition parties to finance the donation. It remains to be seen whether slower growth will become a lasting characteristic of defense outlays.

Revenues - The revenue plan outlined in Table 3 shows that, for the third year in a row, the government will finance operating expenses out of taxes and other revenue sources in FY 1992 and borrow only to fund capital expenditures. In a time of shrinking tax revenues and growing fiscal demands, however, eliminating new issues of deficit-financing bonds carries a price: a sharp 36.3 percent jump in the amount of new construction bonds to be issued. Viewed in terms of absolute amounts, FY 1992's initial projection of ¥7.3 trillion ($53.9 billion) for new project bonds is slightly lower than the figure of two years ago. (With exchange rate changes factored in, the FY 1990 amount was lower in dollars, $51.2 billion.) In terms of the percentage of total revenues, however, FY 1992's 10.1 percent figure compares favorably with ratios in FY 1990 and FY 1991 when construction bonds bore the full load of government's debt financing at 10.5 percent and 9.5 percent, respectively. MOF clearly is keeping a tight rein on the budget deficit, no matter how intense the pressure for an expansive fiscal policy.

Slumping corporate tax receipts in the current fiscal year will inadvertently assist MOF's drive toward its goal of reducing the role of direct taxes in the composition of revenues. Unfortunately, from MOF's viewpoint, direct taxes are expected to account for 63.4 percent of revenues in FY 1992, up from FY 1991's 61.2 percent level thanks to higher receipts from individuals' taxes. MOF analysts are concerned that corporate and individual income taxes concentrate the tax burden unfairly on companies and their employees (who pay taxes via withholding). Indirect taxes can be targeted with greater precision and have less apparent psychological impact on taxpayers than direct levies, they say. Critics dispute these arguments, pointing to the generally regressive nature of indirect taxes and the strong negative reaction by consumers to the April 1, 1989 introduction of a consumption tax.

Paradoxically, indirect taxes' share of total revenues is expected to grow in FY 1992 to 23.1 percent from FY 1991's 22.4 percent, although the category with the greatest projected input has a weak history. A close look at Table 3 reveals that revenues from the controversial consumption tax, which was supposed to reverse the increasing reliance on direct taxes, are expected to drop from 19.2 percent of personal income taxes to 18.2 percent, far behind expectations. Despite tougher monitoring by MOF and more frequent payments (quarterly instead of semiannually), collections through January (10 months of FY 1991) had reached just 47 percent of the fiscal year's projected total of ¥4.9 trillion ($36.3 billion). This experience portends a dim outlook for the growth of consumption tax receipts.

Slower domestic economic activity also spells bad news for other indirect taxes levied on items linked to consumer spending, such as liquor, tobacco and gasoline. The sharpest reversal, however, is expected to come in receipts expected from stock trading. After booming through FY 1987, revenues from this tax have plummeted. With recent trading volumes on organized stock exchanges and over-the-counter way below their peaks of the late 1980s, budget planners realize that the windfall from this source has ended.

Table 3 also indicates that tax equity suffered in FY 1991 and may suffer again in FY 1992. Individuals are expected to bear more of the tax burden for the second consecutive year, a development counter to the consumer-oriented policies adopted by the government in the late 1980s. Personal income taxes provided 59.6 percent of direct tax revenue in FY 1991, well above the most recent high of 55.6 percent recorded in FY 1986 and sharply up from FY 1990's 54.3 percent level. The share held by workers is projected to remain high in FY 1992 at 59.5 percent. At the same time the corporate tax burden continues to fall from its recent high of 48.8 percent in FY 1988 to 40.4 percent in FY 1991 and an expected 39.5 percent in the current fiscal year.

Equity among individual taxpayers also remains an issue, since oversight is minimal in a tax system that allows the self-employed (politically powerful farmers, small shop owners and professionals among them) to avoid taxes. Self-employed professionals historically top the National Tax Agency's annual list of tax cheats, yet the group as a whole still accounts for about one-fifth of total individual income tax revenues. Although the FY 1992 forecast shows that receipts from individuals paying self-assessed taxes are expected to grow slightly faster than receipts from individuals who pay through withholding — 6.2 percent versus 5.9 percent, popular discontent with the system surely will grow, particularly as the government continues to promote consumer spending and a higher standard of living.

Another prospective area of change is the revenue windfall on which Japanese fiscal planners previously have counted — the sale of government-held shares of former public monopolies. Between FY 1988 and FY 1991 prior sales of Nippon Telegraph and Telephone Corp. shares added an extra ¥1.3 trillion ($9.6 billion) a year to public works spending. In the initial general account budget for FY 1992, however, this item has been pared back to just ¥216.6 billion ($1.6 billion). Because public disenchantment with high-priced shares and volatile equity markets have forced the government to postpone new offerings of NTT stock, MOF has not been able to replenish this particular kitty. The government has hopes of selling some of its stock in Japan Tobacco Inc. and the Japan Railways Group, but this depends on the state of equity markets, which is not receptive at this time. In the long run the limited number of shares the government owns of former public monopolies or is planning to sell ultimately limits this revenue source. MOF officals have given no hints on how they plan to replace these revenues.

Fiscal Investment and Loan Program

For the sixth consecutive year Japan's capital budget will set a spending record in FY 1992 (see Table 4). At ¥40.8 trillion ($302.2 billion) outlays will be equivalent to 56.5 percent of the initial general account, keeping them at more than half of the preliminary general account for the fourth straight year. Unless FY 1992's initial general account budget receives heavy supplements, FILP outlays should be above the 50 percent mark at the end of the current fiscal year, as they were in FY 1991 (at 52.1 percent), a first. Over the last several years the rise in the FILP budget consistently has outpaced the growth in the general account budget, a trend that bodes well for fiscal stimulus.

The allocation of FILP monies in FY 1992 differs in many ways from that of FY 1991. Winners for FY 1992 include: social infrastructure other than housing (up 20.1 percent versus 1.7 percent the year before), land conservation (13.1 percent versus 0.6 percent), transportation and communications (51.9 percent versus minus 36.3 percent) and regional development (16.3 percent versus 3.9 percent). Categories suffering lower growth rates include: housing, welfare, education, technology, and foreign economic cooperation. Other categories, such as roads, cash management and small business remain generally about the same. (The fast-growing outlays for "cash management" actually fall into the public works area since much of the money flows into special construction projects.) The growth of each category's annual allocation clearly can fluctuate widely from year to year, perhaps justifying the FILP's reputation as a political pork barrel. The fluctuations also, however, could reflect the uneven demand for funds inherent in FILP's project-specific structure. What can be clearly argued is the second capital budget's growing importance in the government's overall fiscal plan.

Table 4: **Uses and Sources of Japan's Fiscal Investment and Loan Program Outlays (Initial), FY 1988-FY 1992**

(in billions of yen and percent change)

	FY 1988		FY 1989		FY 1990		FY 1991		FY 1992**	
Total Outlays	¥29,614.0	9.4%	¥32,270.5	9.0%	¥34,572.4	7.1%	¥36,805.6	6.5%	¥40,802.2	10.9%
Housing	6,921.5	9.4	7,460.6	7.8	8,365.9	12.1	9,474.5	13.3	9,799.3	3.4
Other Social Infrastructure	4,450.9	11.3	4,371.3	-1.8	4,222.0	-3.4	4,293.3	1.7	5,157.9	20.1
Welfare	661.8	5.4	736.0	11.2	851.9	15.7	1,026.1	20.4	1,109.7	8.1
Education	637.6	-18.7	520.2	-18.4	554.1	6.5	582.4	5.1	582.9	0.1
Small Business	4,030.6	1.1	4,176.4	3.6	4,337.8	3.9	4,494.5	3.6	4,830.1	7.5
Agriculture	979.4	7.9	924.4	-5.6	876.0	-5.2	908.2	3.7	907.9	-0.0
Land Conservation and Disaster Work	409.8	-16.9	357.9	-12.7	328.5	-8.2	330.6	0.6	374.0	13.1
Roads	2,512.1	6.3	2,576.8	2.6	2,700.1	4.8	2,983.2	10.5	3,375.3	13.1
Transportation and Communications	2,229.9	-1.5	2,361.6	5.9	2,304.1	-2.4	1,468.1	-36.3	2,230.4	51.9
Regional Development	652.2	-0.8	676.6	3.7	682.5	0.9	709.0	3.9	824.6	16.3
Industry and Technology	687.2	8.9	758.7	10.4	796.5	5.0	937.7	17.7	965.6	3.0
Foreign Trade and Economic Cooperation	1,171.0	69.6	1,420.0	21.3	1,603.0	12.9	1,898.0	18.4	2,104.5	10.9
Cash Management	4,270.0	27.5	5,930.0	38.9	6,950.0	17.2	7,700.0	10.8	8,540.0	10.9
Total Revenues	¥33,114.0	6.5%	¥34,570.5	4.4%	¥36,572.4	5.8%	¥37,405.6	2.3%	¥41,402.2	10.7%
Industrial Investment Special Account	91.2	-36.8	85.2	-6.6	64.1	-24.8	65.7	2.5	58.1	-11.6
Trust Fund Bureau Fund	26,206.6	6.6	26,871.3	2.5	28,453.3	5.9	29,134.9	2.4	33,489.1	14.9
Postal Savings	7,900.0	0.0	8,500.0	7.6	7,200.0	-15.3	8,800.0	22.2	9,900.0	12.5
Pension Contributions	3,500.0	-21.3	4,310.0	23.1	5,540.0	28.5	6,430.0	16.1	7,230.0	12.4
Other Revenues	14,806.6	20.9	14,061.3	-5.0	15,713.3	11.7	13,904.9	-11.5	16,359.1	17.6
Postal Life Insurance Fund	4,409.4	11.9	5,614.0	27.3	6,055.0	7.9	6,305.0	4.1	6,055.0	-4.0
Government-Guaranteed Bonds and Borrowings	2,406.8	0.3	2,000.0	-16.9	2,000.0	0.0	1,900.0	-5.0	1,800.0	-5.3

Source: Ministry of Finance

An analysis of FILP funding sources reveals some interesting developments. Contributions from the Industrial Investment Special Account, which connects the general account to the FILP budget, appear to have resumed their downward trend after two years of relative stability. It is not clear if MOF intends eventually to sever this link entirely; nor is it clear what advantage this would yield. The role of funds controlled by the postal savings system is expected to continue to be strong in FY 1992 for the second consecutive year. The share of postal savings and life insurance monies in total FILP revenues will be 38.5 percent in FY 1992, down from the previous year's 40.4 percent level. Additions from the government-run pension fund and other government trust monies will continue to provide the majority of FILP revenues in the current fiscal year at 57 percent, only slightly below the recent high mark in FY 1990 of 58.1 percent. As seen from recent years' data, government control of the major sources of FILP funds does not assure stability. MOF's advancing program of financial liberalization will inject profit motives into a system that traditionally has ignored them and likely will force major changes.

MOF's Full Plate Gets More Helpings

Far from being complacent after achieving its goal of eliminating deficit-financing bonds, the Finance Ministry has outlined a long list of fiscal goals and objectives that will occupy its bureaucrats well into the next century. MOF hopes to:

- Reduce total bond issues to less than 5 percent of overall general account revenues by FY 1995.
- Redeem a significant portion of the outstanding national debt (see Tables 5 and 6).
- Restrain the growth of overall government spending to less than the rate of nominal GNP expansion.
- Eliminate budget structures that hide the true size of the deficit and generally make the fiscal blueprint hard to read.
- Improve the government's method of selling its debt. (Deregulation of interest rates has pushed up the average cost of new government bond issues and the refinancing of old ones.)
- Restructure the postal savings system, which eventually must become part of the financial system reform effort.
- Revise government pension and trust funds.

In addition to these self-imposed targets, a host of other objectives is putting, or will put, pressure directly or indirectly on Japanese fiscal policy. As Japan's economy has grown to be the world's second-largest, domestic and foreign leaders have come to expect it to:

- Raise the quality of Japanese life.
- Assist economic development in Third World countries.
- Help resolve the debt crisis of developing countries.
- Aid reconstruction and modernization of Eastern Europe and the former Soviet Union.
- Increase participation in multilateral organizations, such as the International Monetary Fund and the United Nations.
- Help reduce and prevent environmental pollution around the globe.
- Support joint international basic scientific research.

Japanese debate over these goals and objectives is being shaped by current economic and political conditions. The slowing domestic economy coupled with still-weak recoveries in the United States and Germany have generated considerable concern that Japan will experience its first major downturn since the 1973-74 oil crisis. On the political front Tokyo is faced with a rapidly changing global environment in which old rules no longer apply. As far as fiscal policy is concerned, these current economic and political concerns have crystallized into debate over two issues:

Public Works Spending - This issue has both an international and a domestic component. In the 1989-90 Structural Impediments Initiative talks with the United States Tokyo agreed to budget

Table 5: **Japan's Current General Account Budget Deficit, FY 1970-FY 1992**

(in billions of yen and percent of total spending)

Fiscal Year	Initial Budget								Revised Budget	
	Construction Bonds		Deficit Bonds		Total Bonds		Debt Service		Total Bonds	
1970	¥430	5.4%	0	n.a.	¥430	5.4%	¥290.9	3.7%	¥347	4.2%
1971	430	4.6	0	n.a.	430	4.6	319.3	3.4	1,220	12.6
1972	1,950	17.0	0	n.a.	1,950	17.0	455.4	4.0	2,310	19.1
1973	2,340	16.4	0	n.a.	2,340	16.4	704.5	4.9	1,810	11.9
1974	2,160	12.6	0	n.a.	2,160	12.6	862.2	5.0	2,160	11.3
1975	2,000	9.4	0	n.a.	2,000	9.4	1,039.4	4.9	5,480	26.3
1976	3,525	16.0	¥3,750	19.3%	7,275	29.9	1,664.7	6.9	7,375	29.9
1977	4,430	11.9	4,050	17.8	8,480	29.7	2,348.7	8.2	9,985	34.0
1978	6,050	13.6	4,935	18.4	10,985	32.0	3,222.7	9.4	11,285	32.8
1979	7,215	12.5	8,055	27.1	15,270	39.6	4,078.4	10.6	14,050	35.4
1980	6,785	11.5	7,485	22.0	14,270	33.5	5,310.4	12.5	14,270	32.7
1981	6,785	11.8	5,485	14.4	12,270	26.2	6,654.2	14.2	12,900	27.6
1982	6,516	11.5	3,924	9.5	10,440	21.0	7,829.9	15.8	14,345	30.2
1983	6,365	9.9	6,980	16.6	13,345	26.5	8,192.5	16.3	13,486	26.1
1984	6,225	9.8	6,455	15.2	12,680	25.0	9,155.1	18.1	12,781	24.5
1985	5,950	9.4	5,730	12.8	11,680	22.2	10,224.1	19.5	12,308	22.8
1986	5,700	8.9	5,246	11.3	10,946	20.2	11,319.5	20.9	11,495	21.4
1987	5,520	10.2	4,981	9.2	10,501	19.4	11,333.5	20.9	10,539	18.1
1988	5,690	10.0	3,151	5.6	8,841	15.6	11,512.0	20.3	7,967	12.9
1989	5,780	9.6	1,331	2.2	7,111	11.8	11,664.9	19.3	7,111	10.7
1990	5,593	8.4	0	0.0	5,593	8.4	14,449.3	20.7	7,312	10.5
1991	5,348	7.6	0	0.0	5,348	7.6	15,834.3	22.5	6,730	-8.0
1992	7,280	10.1	0	0.0	7,280	10.1	16,447.3	22.8	n.a.	n.a.

Source: Bank of Japan and Ministry of Finance

Table 6: **Japan's Cumulative General Account Budget Deficit, FY 1970-FY 1991**

(in billions of yen and percent of nominal gross national product)

Fiscal Year	Construction Bonds		Deficit Bonds		Refinancing Bonds		Total Bonds	
1970	¥2,642.2	3.5%	¥168.8	0.2%	0.0	0.0	¥2,811.0	3.7%
1971	3,851.1	4.7	100.9	0.1	0.0	0.0	3,952.0	4.8
1972	5,818.5	6.0	0.0	0.0	0.0	0.0	5,818.5	6.0
1973	6,943.5	6.0	0.0	0.0	¥606.8	0.5%	7,550.3	6.5
1974	8,403.6	6.1	0.0	0.0	1,254.8	0.9	9,658.4	7.0
1975	11,178.4	7.3	2,116.9	1.4	1,677.7	1.1	14,973.0	9.8
1976	14,530.1	8.5	5,492.8	3.2	2,053.6	1.2	22,076.5	12.9
1977	19,280.8	10.1	10,253.5	5.4	2,367.9	1.2	31,902.2	16.8
1978	24,964.7	12.0	14,647.2	7.0	3,003.7	1.4	42,615.6	20.4
1979	32,181.7	14.3	21,065.7	9.3	3,003.7	1.3	56,251.1	25.0
1980	38,953.5	15.9	28,257.1	11.5	3,299.1	1.3	70,509.7	28.8
1981	45,149.7	17.4	32,916.3	12.7	4,207.3	1.6	82,273.3	31.7
1982	48,589.4	17.8	40,330.1	14.8	7,562.5	2.8	96,482.0	35.4
1983	51,366.3	18.1	47,059.9	16.6	11,268.4	4.0	109,694.6	38.6
1984	53,447.9	17.6	53,074.5	17.5	15,171.0	5.0	121,693.4	40.2
1985	52,830.3	16.4	57,306.0	17.8	24,295.0	7.6	134,431.3	41.8
1986	52,745.0	15.8	58,846.3	17.6	33,535.2	10.0	145,126.5	43.4
1987	51,923.4	14.8	56,803.0	16.2	43,082.8	12.3	151,809.2	43.2
1988	49,307.3	13.2	54,365.5	14.6	53,107.4	14.3	156,780.3	42.1
1989	48,732.6	12.0	47,825.5	11.8	64,351.8	15.8	160,910.0	39.6
1990	48,065.3	11.0	41,136.6	9.4	77,136.0	17.7	166,337.9	38.1
1991*	47,571.8	10.6	29,253.1	9.8	79,564.2	17.8	166,389.1	37.2
1991**	n.a.	—	n.a.	—	n.a.	—	170,633.7	37.1

*As of end of August 1991. Percent of GNP based on projected FY 1991 nominal growth of 5.2 percent.
**As of end of February 1992. Percent of GNP based on projected FY 1991 nominal growth of 5.2 percent.

Sources: Bank of Japan and Ministry of Finance

¥430 trillion ($3.2 trillion) for public works spending over the next decade, a figure calculated to boost the ratio of public works outlays to projected GNP to over 7 percent (see *JEI Report* No. 26B, July 6, 1990). This would be sharply higher than the ¥274 trillion ($2 trillion-plus) spent during the FY 1981-FY 1990 period. To achieve the new goal public works spending will have to grow about 6.1 percent annually. While FY 1992 spending projections easily surpass this mark, there is no guarantee that the pace of spending will remain high. If Japan does not commit the pledged amount, the shortfall, by itself, is unlikely to become a major bilateral irritant, but it could add fuel to other simmering issues.

Domestically, Prime Minister Kiichi Miyazawa has pledged to make Japan a consumer superpower and, more recently, has promised to spur domestic growth through higher government spending. Given the priorities outlined in the FY 1992 general account budget, public works projects clearly are key to this objective. There is growing concern, however, that boosting public works spending may not be effective. If significant purchases of expensive land are part of the public works plan, much of the higher spending may be committed in ways that do not create new demand for goods and services. (In fact, such expenditures could reignite real estate speculation in areas where new projects are located, a distinctly undesirable result.) Another concern is inflation, since Tokyo's last sharp spur to public works spending in the late 1980s resulted in higher inflation in the construction and building materials industries. Furthermore, critics point out that Japanese construction companies cannot now take on more business; their order books already are backed up as much as a year.

Global Responsibility Fund - The difficulties Tokyo faced raising funds for Japan's contribution to defray the allies' costs of the Persian Gulf crisis demonstrated to government leaders there the need for a pool of money for emergencies. If Japan truly is to accept greater international responsibilities, the money to act must be available at a moment's notice, some government officials have argued. In the fall of 1991 the ruling Liberal Democratic Party and the government floated several ideas to impose a tax specifically for a "global responsibility" fund. The idea of a special tax on fossil fuels to fund environmental programs also has been raised. Public reaction to both proposals was swift and negative. Nevertheless, MOF has earmarked as available for special projects revenues from a new land-holding tax and a special surcharge on corporate income taxes.

Conclusion

The Finance Ministry's budget duties were lightened considerably in the late 1980s by an expanding revenue pie that allowed the apportioning of funds to a growing number of projects at the same time that existing ones fared better, too. Since FY 1990, however, the revenue pie has grown much less rapidly, while demand for new spending has continued to expand apace. Further complicating MOF's current fiscal planning are forces beyond its control, such as foreign pressure, financial market restructuring and unpredictable equity markets. Perhaps the biggest threat to MOF's fiscal austerity tenet in FY 1992 will be the dragging economy. The slowdown, which appears to have surprised everyone with its rapid onset and steep descent, has increased geometrically the pressure for bigger public works spending. The government's FY 1992 spending plan already has forced MOF to accept an increase in construction bond outlays. If the slowdown becomes a deep recession, it could endanger MOF's self-imposed ban on new deficit-financing bonds. The clamor for government stimulation aside, the expected tax revenue shortages are sure to pressure MOF's existing budgets just as effectively. The flexibility and ingenuity — as well as resolve — of MOF budget planners will be sorely tested in the coming years.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.